Yardeni Research

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Morning Briefing

On Trump 2.0, Global Growth, Argentina & S&P 500 Profit Margins

Check out the accompanying chart collection.

Executive Summary: It's evident how much policy uncertainty is baked into the dollar's value from its whipsawing during the first two days of Trump 2.0 in reaction to changed expectations regarding the timing of the new tariffs. Despite concerns of higher prices and a trade war, there's the potential for tariffs to expand manufacturing capacity, which would be disinflationary. … Also: Melissa shares highlights from the IMF's new global GDP growth projections and discusses why we think the Argentinian stock market is one to watch. … And: Joe recaps data on S&P 500 companies' forward profit margins, which have been on the rise across most sectors.

Weekly Webcast. If you missed Tuesday's live webcast, you can view a replay *here*.

Global Economy I: Tariff & Energy Turbulence. The DXY dollar index has whipsawed over the past 48 hours, ultimately falling 1.3% on Tuesday. Monday's action was telling of the market's sensitivity to headlines. The DXY fell around 1% early Monday on a report that President Trump wouldn't enact tariffs on Day 1 of his new term, only to partially erase that move after Trump said he plans to impose 25% tariffs on Mexico and Canada by February 1. He also threatened more tariffs on China and reiterated the possibility of universal tariffs.

Despite the headline trading, Trump's initial wave of executive orders didn't veer off the path he signaled going into the inauguration. One takeaway is how much prospective policy and uncertainty are already baked into the dollar, which is up 15% over the past three years (*Fig. 1*).

Trump 2.0 has a predilection for tariffs, and they will come either as negotiating tools, pay-fors, or a combination of the two. Even if tariffs are seen as a tax on consumption, foreigners pay for at least part of it via a devalued currency.

Considering that US manufacturing and capacity have stagnated since China entered the

World Trade Organization in 2001, the Trump administration thinks tariffs are necessary to rebalance global trade and end unfair practices abroad (*Fig. 2*). We tend to agree but are aware of possible negative unintended consequences such as trade and currency wars. Tariffs might boost manufacturing capacity in the US, which would be disinflationary over the long run, and supply chains are far more equipped to handle disruptions today than they were eight years ago at the start of Trump's first term.

We are against tariffs in theory. However, in practice, they might successfully rebalance global trade and, in combination with supply-side policies, shore up domestic production. Here's more on how we're thinking about tariffs:

(1) *China*. China-targeted tariffs won't be revealed until the new administration evaluates the trade deal struck during Trump 1.0. Likely, there will be debate over the merits of high tariffs limited to specific imports versus one that affects all goods, or even sweeping tariffs will capture third parties in Chinese supply chains, like Vietnam.

Notably, China's exports to Vietnam have surged as tariffs have been ratcheted up, growing from $66 billion in 2015 to $157 billion as of Q3-2024 (*Fig. 3*). This is also a reason why we think tariffs on China will be successful—China needs to export to the US as it tries to export its way out of a property recession. Devaluing the yuan to offset the effect of tariffs isn't a viable strategy for China this time around, either. Any further weakening will likely risk capital flight considering that China has already let the yuan weaken due to both its domestic recession and tariff risk. It's down roughly 15% relative to the dollar over the past year (*Fig. 5*).

(2) *Oil*. On Monday, Trump declared a national energy emergency and withdrew from the 2015 Paris climate deal. He also signed executive orders to promote oil and gas development in Alaska, reversed protections of Arctic lands and U.S. coastal waters from drilling, did away with the electric vehicle mandate, suspended offshore wind lease sales, and unfroze new LNG export permits.

The WTI crude oil price fell 2.3% on Tuesday. It might've been down further had the Canadian tariffs not threatened Canadian oil, or had Trump not said that the US would fill its Strategic Petroleum Reserve "right to the top," implying the purchase of roughly 300 million barrels.

We think Trump 2.0 will mostly be a negative for oil prices. In the most extreme scenario, global trade and economic growth are reduced by a trade war, weighing on oil prices. On the flipside, leases and permits for oil and gas drilling, as well as general deregulation, are likely to significantly boost oil supply. This would also give Trump another point of leverage as the US increasingly becomes a major energy exporter. We believe this is of the utmost priority for Trump 2.0.

Global Economy II: No Surprises in IMF's Global Growth Forecast. We generally agree with the latest forecasts of the International Monetary Fund (IMF). Global real GDP growth is expected to slow from its pre-pandemic pace, according to the IMF's January 2025 update. However, we expect that US economic growth will be better than projected by the IMF.

The IMF expects global growth at a stable, but lackluster, 3.3% y/y clip for both 2025 and 2026, slightly below the pre-pandemic average of 3.7%. The increase in the forecast for US growth was offset by weaker projections for other major economies. The IMF believes that risks to their US growth outlook are to the upside, too. However, the global forecast has more downside risk in the intermediate term, mostly due to policy uncertainty. While global financial conditions are largely accommodative, uncertain trade policy and fiscal instability remain challenges.

Global inflation is projected to ease, falling to 4.2% y/y in 2025 and 3.5% y/y by 2026. Advanced economies are expected to return to target inflation levels sooner than emerging markets.

Here's a tour of the IMF's projected growth rates around the world:

(1) The US economy stands out among developed nations with a revised real GDP growth forecast of 2.7% for 2025 and 2.1% for 2026, with risks tilted to the upside (*Fig. 5*). Upside risks to the US outlook include increased business confidence driven by deregulation and lower taxes under Trump 2.0. Should the animal spirits spark a revival in inflation, higher interest rates could become a risk scenario. In our productivity-led Roaring 2020s scenario, real GDP could exceed 3.0% this year, while inflation remains around 2.0%

(2) In the Eurozone, real GDP is expected to grow just 1.0% this year due to weakness in manufacturing and energy concerns. In 2026, growth is set to perk up to 1.4%, aided by looser financial conditions and improving confidence (*Fig. 6*). We agree.

(3) Real GDP growth in Japan and the UK are expected to remain weak, running below 2.0% y/y through 2026 (*Fig. 7* and *Fig. 8*). We agree.

(4) China faces a dip further below the government's 5.0% real GDP target to 4.6% growth in 2025, down from 4.8% in 2024, as weak domestic demand and a fragile trade environment threaten growth. An increasing retirement age and fading uncertainty can aid growth in 2026, but perhaps not enough (*Fig. 9*). Again, we agree.

(5) India's GDP growth should stay solid at 6.5% projected for both 2025 and 2026 following the same in 2024 (*Fig. 10*). Ditto: We agree.

(6) In several regions of the globe, GDP growth is expected to pick up in 2025: the Middle East and Central Asia, Latin America and the Caribbean, and sub-Saharan Africa. It is forecast to slow in the emerging and developing countries of Europe. That all makes sense to us.

Global Economy III: Making Argentina Great Again. US President Donald Trump recently *congratulated* Argentina's President Javier Milei for "making Argentina great again." Billionaire US presidential advisor Elon Musk also has applauded Milei for reforming Argentina to within the vicinity of economic normalcy.

Some have called Milei's results no less than an "economic miracle." Investors agree: The MSCI Argentina stock market index has risen nearly 120% in local currency since Milei became president (*Fig. 11*). In our view, the Argentinian president has made great strides in lowering inflation and stimulating growth with his pro-free market policies. The emerging market still has a way to go before we would consider it to be a safe investment, however.

Argentina's stock market is one to watch, especially if Milei can position his nation to remove its controls on the currency without destabilizing it.

Here's more:

(1) *Inflation cooling, but still hyper.* When Milei took office in December 2023, Argentina's inflation rate was 25.5% m/m and 211.4% y/y. It fell all the way down to 2.7% m/m and to 117.8% y/y in December 2024 (*Fig. 12* and *Fig. 13*).

(2) *Astronomical cost of borrowing falling.* While the country's central bank eased its policy rate from 118.0% during Q4-2023, it remains exceedingly expensive for Argentinians to borrow at 40.0% as of Q4-2024 (*Fig. 14*).

(3) *Deregulation successes*. Milei has managed to counter the central bank's interest-rate

cuts by cooling inflation with austerity measures. Milei's administration has cut spending and subsidies, bringing the national treasury out of its deepest deficit on record in December 2023 (*Fig. 15*).

(4) *Deregulation challenges.* Initially, the fiscal tightening slowed growth and worsened unemployment. But these upfront costs may already be subsiding. Through Q3-2024, growth has picked up on both quarterly and annualized bases, and the unemployment rate has fallen from that of the previous quarter (*Fig. 16* and *Fig. 17*).

(5) *Currency still controls.* By the end of this year, Milei wants to end currency controls that have been in place for nearly a decade. Argentina's currency management measures include limiting the purchase of foreign currency savings to $200 per month, taxing overseas travelers, curtailing the amount of US dollars used in exporting, and forcing exporters to exchange their dollars for pesos.

Since April 2022, the Argentinian peso has remained relatively stable, thanks to the controls. From a recent low during January 2024 to November 2024, the country's real broad effective exchange rate has appreciated by more than 50.0% (*Fig. 18*).

(6) *Limits of unleashing the currency.* Argentina's government has set *conditions* to guide the timing for safely pulling back the currency regulation without creating a run on it. It wants monthly inflation to run at less than an increase of 2.5%, positive central bank reserves, and a 20% gap on market-to-government established exchange rates. Meeting each of these conditions seemed impossible last year, but Argentina is edging closer to doing so and easing the currency restrictions.

(7) *Dollarization strides.* To bolster currency competition, the central bank is making steps toward "dollarizing" the Argentinian economy. Effective on February 28, the central bank will *allow* payment intermediaries to accept debit-card transactions in US currency.

Strategy: Profit Margin Forecasts on the Rise. The S&P 500's forward profit margin was at record-high 13.6% during the January 18, 2025 week, up 0.9ppt y/y from 12.7% a year earlier (*Fig. 19*). Corporate profitability should continue to improve even as Trump's administration faces a big fiscal headwind. (FYI: The forward profit margin is calculated from forward earnings and revenues, which are the time-weighted averages of industry analysts' consensus estimates for S&P 500 companies collectively for the current year and following one.)

Below, Joe reviews what occurred with the S&P 500's forward profit margin during Trump's first administration and where analysts' revenue and earnings estimates have put forward profit margins lately:

(1) *Trump 45 and 2018's TCJA boosted profit margins.* During Trump's first administration, Congress passed the Tax Cut & Jobs Act (TCJA) in mid-2017, and it was implemented in 2018. At the end of 2017 before the TCJA took effect, the S&P 500's forward profit margin was at a then-record-high 11.1%. Following the passage of TCJA, the S&P 500's profit margin soared 0.9ppts to 12.0% in just three short months. It then peaked at 12.4% in September 2018 before settling back down to 12.0% as the global economy slowed before the pandemic.

(2) *Trump 47's tax cut options are limited.* Trump has less room to cut corporate tax rates than during his first term. The US corporate tax rate is now already in line with those of major industrialized nations, but the massive spending of the past four years by the prior administration has limited Trump's tax-cut options. According to the *Tax Foundation*, further reductions in the corporate tax rate would swell the federal budget deficit without doing much to improve economic or employment growth. So a renewal of the TCJA is more likely, and easier to pass instead of new legislation. This stable outlook for tax rates, along with reduced government regulations, will help corporations invest domestically and leverage the efficiencies and cost savings offered by AI and robotics.

(3) *Many sectors still showing profit margin improvement.* In what's turning into a broad uptrend, the forward profit margin has risen y/y for eight of the 11 S&P 500 sectors (*Fig. 20*). Not all sectors' forward margins are at record highs, but most are close. The biggest y/y improvements were recorded by Communication Services (up 2.0ppts to 18.6%), Financials (1.6ppts to 19.9%), Information Technology (1.2ppts to 26.9%), Consumer Discretionary (0.9ppt to 9.4%), and Utilities (0.9ppt to 14.4%).

Also improving y/y, but much less so, were the forward profit margins of the Industrials, Real Estate, and Materials sectors. Among the laggards, Energy's forward margin fell 1.0ppts y/y to 9.6%, while those of Consumer Staples and Health Care were unchanged.

Joe recently added a table of forward profit margins for the S&P 500's industries to our *Performance Derby* publication; see Table 17. Several S&P 500 sub-industries have made notable y/y gains. Within Communication Services, Interactive Media & Services rose 3.4ppts y/y to 27.2% and Movies & Entertainment gained 2.0ppts to 10.7%. In Financials, the biggest forward profit margin improvers over the past year are Multi-Line Insurance

(5.6ppt to 15.4%) and Regional Banks (3.5ppts to 25.6%). The award for the highest forward margin of all S&P 500 industries goes to Semiconductors, residing in the Information Technology sector. Semiconductors' forward margin has soared 5.7ppts y/y to a record-high 39.0%.

Calendars

US: Leading Indicators 0.0%; MBA Mortgage Applications; Weekly Crude Oil Inventories. **Thurs:** Jobless Claims 218k; EIA Natural Gas Storage & Gasoline Production; Fed Balance Sheet. (FXStreet estimates)

Global: **Wed:** Canada PPI 0.6%m/m; Lagarde. **Thurs:** Eurozone Consumer Confidence Flash -14.2; France Business Confidence 96; UK CBI Business Optimism Index; UK Gfk Consumer Confidence -18; Japan Core Inflation Rate 3.0%y/y; BoJ Interest Rate Decision 0.50%. (FXStreet estimates)

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